

REPORT OF THE AUDITOR-GENERAL TO THE EASTERN CAPE PROVINCIAL LEGISLATURE AND THE COUNCIL OF MBIZANA LOCAL MUNICIPALITY

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I was engaged to audit the accompanying financial statements of the Mbizana Local Municipality, which comprise the statement of financial position as at 30 June 2011, and the statement of financial performance, statement of changes in net assets and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory information, as set out on pages ... to

Accounting officer's responsibility for the financial statements

2. The Accounting authority is responsible for the preparation and fair presentation of these financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2010 (Act No. 1 of 2010 as amended) (DoRA), as well as for such internal control as management determines necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor-General's responsibility

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 (Act No. 108 of 1996) and section 4 of the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), my responsibility is to express an opinion on the financial statements based on conducting the audit in accordance with the International Standards on Auditing and General notice 1111 of 2010 issued in Government Gazette 33872 of 15 December 2010. Because of the matters described in the Basis for disclaimer of opinion paragraphs, however, I was unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for disclaimer of opinion

Property, plant and equipment

4. I was unable to verify assets that were reflected on the asset register as Property, Plant and Equipment of the municipality. The value of these assets is R9, 6 million. I was unable to verify these assets via alternative procedures, and satisfy myself regarding the existence assertion. In addition, there were assets that were identified as Property, Plant and Equipment of the municipality, which I was unable to trace to the fixed asset register. The value of these assets is R1, 1 million, and I was unable to satisfy myself regarding the completeness assertion.

Trade and Other Payables

5. The municipality could not provide sufficient appropriate audit evidence for the amount of R 3, 4 million as disclosed as other payables, in note 11 to the financial statements. There were no satisfactory alternative audit procedures I could perform to obtain reasonable assurance on the balance.
6. In addition to the above, the municipality has failed to recognise accruals at year end to the value of R 1, 1 million in the annual financial statements. The municipality did not have adequate systems to maintain records of accounts payable for goods and services received but not yet paid.
7. Furthermore the municipality failed to account for, and disclose the accrual for Workman's compensation, resulting in an understatement of accruals in the Statement of Financial Position, and the corresponding understatement of workman's compensation expense, in the Statement of Financial Performance for the year ended 30 June 2011. The value of the omission is R1 million. .

Other receivables from non exchange transactions

8. The municipality did not submit sufficient, appropriate audit evidence to support the balance relating to other receivables from non - exchange transactions amounting to R3, 9 million. The balance relates to uncleared bank reconciling items from the previous financial year, which remains unsupported in the current financial year. There were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance that the aforementioned amount was properly recorded.
9. Consequently I was not able to satisfy myself on the existence, valuation, allocation and rights of the debtor amounting R3, 9 million presented as other receivables from non exchange transactions in the statement of financial position and disclosed in note 4 to the financial statements.

Consumer debtors

10. The municipality could not provide sufficient and appropriate audit evidence to support journal entry processed to consumer debtors amounting to R 2, 8 million. There were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance that the journal entries were properly recorded. In addition to this, the municipality did not submit sufficient, appropriate audit evidence to support the material credit entry processed relating to trade debtors in the debtors control account, amounting to R4, 6 million. There were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance that the aforementioned amount was properly recorded.

Value added tax receivable

11. The municipality could not provide sufficient appropriate audit evidence to support the difference of R1, 4 million noted between the VAT returns completed and submitted for the year and the amount disclosed in the statement of financial position and note 7 to the financial statements of R4, 3 million.

Accumulated surplus

12. The municipality could not provide sufficient appropriate audit evidence to support a journal entry processed to correct an error passed and disclosed against the opening balance of Accumulated Surplus to the extent of R4, 5 million. There were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance that the opening balance of accumulated surplus is properly disclosed. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself that the opening balance is properly recorded

Irregular expenditure

13. Section 62 of the Municipal Finance Management Act, (no. 56 of 2003) requires the municipality to implement and maintain an appropriate procurement and provisioning system which is fair, equitable, transparent, competitive and cost effective. Expenditure to the amount of R4, 6 million included in the statement of financial performance was incurred in the period as a result of the contravention of the SCM legislation. This amount was not included in irregular expenditure disclosed in note 39 the annual financial, resulting in irregular expenditure being understated by R4, 6 million.

Commitments

14. Commitments of R30, 7 million (2010: Nil) (as disclosed in note 25 to the financial statements), do not agree to the balance of R27, 2 million (2010: Nil) per the accounting records. The municipality could not provide explanations or supporting documentation for the difference of R3, 5 million (2010: Nil). Consequently commitments are overstated by R 3,5 million (2010:Nil)

Accumulation of immaterial uncorrected misstatements

15. The financial statements as a whole are materially misstated by R3.6 million and R2, 6 million respectively due to the cumulative effect of various individually immaterial uncorrected misstatements making up the statement of financial position , and the statement of financial performance

Corresponding Figures

16. The auditor's report for the year ended 30 June 2010 contained a disclaimer of opinion on the financial statements as a whole due to a limitation on the scope of the audit. The matters which gave rise to the limitation, as described below, remain unresolved in the current year.
17. The municipality could not provide sufficient appropriate audit evidence regarding:
- Trade and other payables of R4,6 million disclosed in note 11 to the financial statements;
 - Other receivables from non-exchange transactions of R1,2 million disclosed in note 4 to the financial statements;
 - Accumulated surplus of R11,6 million disclosed in the financial statements;

18. I was unable to confirm or verify these amounts by alternative means and as a result, could not confirm the existence, valuation, completeness or rights and obligations of the abovementioned amounts included in the corresponding figures.

Disclaimer of opinion

19. Because of the significance of the matters described in the Basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, I do not express an opinion on the financial statements.

Emphasis of matter

I draw attention to the matters below. My opinion is not modified in respect of these matters:

Restatement of comparative figures

20. As disclosed in note 32 and 33 to the financial statements, the corresponding figures for 30 June 2011 have been restated as a result of errors discovered during 2011 in the financial statements of the Mbizana Local Municipality at, and for the year ended, 30 June 2010.

Irregular expenditure

21. As disclosed in note 39 of the annual financial statements the municipality incurred irregular expenditure of R936 778 as the expenditure incurred was in contravention of supply chain management regulations.

Fruitless and wasteful expenditure

In note 41 of the financial statements the municipality incurred fruitless and wasteful expenditure to the extent of R547 493 due to penalties arising from late payment of PAYE due to the South African Revenue Service.

Material Impairments

22. As disclosed in note 3 of the annual financial statements the municipality has an impairment loss amounted to R 3 031 718 (2010: R 3 848 674). The impairment relates to consumer debtors which had been outstanding for more than 12 months and are considered to be doubtful.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

23. In accordance with the PAA and in terms of *General notice 1111 of 2010*, issued in *Government Gazette 33872 of 15 December 2010*, I include below my findings on the annual performance report as set out on pages xxx to xxx and material non-compliance with laws and regulations applicable to the municipality.

Predetermined objectives

24. Material findings on the report on predetermined objectives, as set out on pages xxx to xxx, are reported below:

Usefulness of information

25. The following criteria are relevant to the findings below:

- Consistency: Objectives, indicators and targets are consistent between planning and reporting documents
- Relevance: A clear and logical link exists between the objectives, outcomes, outputs, indicators and performance targets

Audit Finding

Reported information not consistent with planned objectives, indicators and targets

26. Mbizana Local Municipality did not report throughout the period ended 30 June 2011 on its performance against predetermined objectives, indicators and targets which are consistent with the approved integrated development plan. For the selected programmes, 24% of reported indicators were not consistent or not complete when compared with planned indicators.

27. For the Service Delivery programme, 50% of reported objectives were not consistent when compared with planned objectives, 59% of reported indicators were not consistent when compared with planned indicators and 37% of reported targets when targets were not consistent when compared with planned targets.

Reported information not relevant as no clear or logic link between the indicator and objective

28. For the Service Delivery programme, 21% of the development objectives have no clear link between the indicators and performance targets.

Reliability of information

29. The following criteria are relevant to the findings below:

- Validity: Actual reported performance has occurred and pertains to the entity
- Accuracy: Amounts, numbers, and other data relating to reported actual performance have been recorded and reported appropriately

Audit Finding

Corroborating evidence for reported measures taken to improve performance was not provided.

30. For the selected programmes, corroborating evidence for 100% of the instances identified where measures were taken to improve performance was not provided.

Compliance with laws and regulations

31. Included below are findings on material non-compliance with laws and regulations applicable to the municipality

Strategic planning and performance management

32. The accounting officer of the municipality did not by 25 January assess the performance of the municipality during the first half of the financial year, taking into account the municipality's service delivery performance during the first half of the financial year and the service delivery targets and performance indicators set in the service delivery and budget implementation plan as required by section 72(1)(a)(ii) of the MFMA .
33. The accounting officer of the municipality did not submit the results of the assessment on the performance of the municipality during the first half of the financial year to the mayor of the municipality, the National Treasury, and the provincial treasury as required by section 72(1)(b) of the Municipal Finance Management Act.

Annual financial statements, performance and annual report

34. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the Municipal Finance Management Act. Material misstatements of capital assets, current assets, liabilities, revenue, expenditure, disclosure items identified by the auditors were subsequently corrected, but the uncorrected material misstatements resulted in the financial statements receiving a disclaimer audit opinion.
35. The accounting officer did not make the 2009/10 annual report public immediately after the annual report was tabled in the council as required by section 127(5) of the Municipal Finance Management Act.
36. The accounting officer did not make public the council's oversight report on the 2009/10 annual report within seven days of its adoption, as required by section 129(3) of the Municipal Finance Management Act.
37. The annual performance report did not contain a comparison of the performance of the municipality and of each external service provider with development priorities, objectives and performance indicators set out in its integrated development plan as required by section 46 of the Municipal Systems Act.

Audit committees

38. No audit committee was in place for the full year as required by section 166(1) of the Municipal Finance Management Act.

39. The audit committee did not function as required by section 166 of the Municipal Finance Management Act, in that:

- The audit committee did not advise the council/ the political office bearers/ the accounting officer and/or the management staff of the municipality on matters relating to internal financial control and internal audits/ risk management/ accounting policies/ performance management/ effective governance/ compliance with applicable legislation and/or performance evaluation;
- The audit committee did not review the annual financial statements;
- The audit committee did not respond to the council on any issues raised by the Auditor-General in the audit report;
- The audit committee did not meet at least four times a year.

40. The audit committee did not advise the council of the municipality on the adequacy, reliability and accuracy of financial reporting and information as required by section 166(2)(a)(iv) of the Municipal Finance Management Act.

41. The audit committee did not advise the municipal council, the political office bearers, the accounting officer and the management staff of the municipality on matters relating to compliance with the Municipal Finance Management Act, the Division of Revenue Act and other applicable legislation as required by section 166(2)(a) of the Municipal Finance Management Act.

42. The municipality did not appoint and budget for a performance audit committee, nor was another audit committee utilised as the performance audit committee as required by Municipal Planning and Performance Management Regulation 14.

43. The performance audit committee or another committee functioning as the performance audit committee did not perform the following as required by Municipal Planning and Performance Management Regulation 14:

- meet at least twice during the financial year;
- review the quarterly reports of the internal auditors on their audits of the performance measurements of the municipality;
- review the municipality's performance management system and make recommendations in this regard to the council of the municipality;
- submit an auditor's report to the council regarding the performance management system at least twice during the financial year.

Internal audit

44. The internal audit unit did not function as required by section 165(2) of the Municipal Finance Management Act, in that:

- Internal audit did not advise the accounting officer and/or report to the audit committee on matters relating to [internal audit/ internal controls/ accounting procedures and practices/ risk and risk management and/or loss control

45. Internal audit did not report to the audit committee on matters relating to compliance with the Municipal Finance Management Act, the Division of Revenue Act and other applicable legislation as required by section 165(2)(b) of the Municipal Finance Management Act.

Procurement and contract management

46. Sufficient appropriate audit evidence could not be obtained that goods and services of a transaction value above R200 000 were procured by means of inviting competitive bids as per the requirements of SCM regulation 19(a) and 36(1).
47. Sufficient appropriate audit evidence could not be obtained that awards were to providers based on criteria that were similar to those stipulated in the original bid documents and/or were stipulated in the original bid documents as per the requirements of SCM regulation 21(b) and/or 28(1).
48. Sufficient appropriate audit evidence could not be obtained that invitations for competitive bidding were advertised for a required minimum period of days as per the requirements of SCM regulation 22(1) & 22(2).
49. Sufficient appropriate audit evidence could not be obtained that bids were evaluated by bid evaluation committees which were composed of officials from the departments requiring the goods or services and at least one SCM practitioner of the municipality as per the requirements of SCM regulation 28(2).
50. Sufficient appropriate audit evidence could not be obtained that final awards and/or recommendation of awards to the accounting officer were made by an adjudication committee constituted as per the requirements SCM regulation 29(2).
51. Awards were made to providers who are persons in service of state in contravention of the requirements of SCM regulations 44. Furthermore the provider failed to declare that they were in the service of the state as required by SCM regulation 13(c)

Human resource management and compensation

52. Senior managers directly accountable to the municipal manager did not sign annual performance agreements for the year under review, as required by sections 57(1)(b) and 57(2)(a) of the Municipal Systems Act.
53. The municipal manager did not sign an annual performance agreement for the year under review, as required by sections 57(1)(b) and 57(2)(a) of the Municipal Systems Act.

Expenditure management

54. The accounting officer did not take reasonable steps to prevent irregular, fruitless and wasteful expenditure, as required by section 62(1)(d) of the Municipal Finance Management Act.
55. The municipality did not recover irregular, fruitless and wasteful expenditure from the liable person, as required by section 32(2) of the Municipal Finance Management Act.

Revenue management

56. Revenue received by the municipality was not always reconciled at least on a weekly basis, as required by section 64(2)(h) of the Municipal Finance Management Act.

INTERNAL CONTROL

In accordance with the PAA and in terms of General notice 1111 of 2010, issued in *Government Gazette 33872 of 15 December 2010*, I considered internal control relevant to my audit, but not for the purpose of expressing an opinion on the effectiveness of internal control. The matters reported below are limited to the significant deficiencies that resulted in the basis for disclaimer of opinion, the findings on the annual performance report and the findings on compliance with laws and regulations included in this report.

Leadership

57. The accounting officer did not exercise the required oversight responsibilities to ensure compliance with laws and regulations and internal control. Furthermore the accounting officer did not properly review financial statements and predetermined objectives prior to submission for audit; this led to numerous control deficiencies, errors in the financial statements and the non-compliance findings detailed above. Policies and procedures to ensure that all transactions are accounted for in terms of GRAP requirements were not developed and communicated to staff members in the municipality's finance section.
58. The accounting officer did not exercise oversight over adherence to the supply chain management regulations. The non-adherence to supply chain management regulations resulted in irregular expenditure. Furthermore there are no documented policies and procedures in place to sufficiently communicate tasks for the adequate accounting and identification of expenditure that is irregular.
59. For predetermined objectives, the documented policy and procedure manuals were found not to have been implemented. As a result, significant deficiencies were identified in the performance report on predetermined objectives.

Financial and performance management

60. Instances were identified where quality, reliable monthly financial statements and management information was not prepared by the municipality. Pertinent information is not identified and captured in a form and time frame to support financial and performance reporting. Numerous errors were noted on the annual financial statements submitted. Which is an indication that the financial statements were not adequately reviewed by management before submitting the final version for audit?
61. The municipality does not have proper record keeping and record management processes in place to ensure that the documentation supporting the amounts and disclosures in the financial statements are properly filed and easily retrievable. Information requested for audit purposes was not readily available and significant delays were experienced throughout the audit process. In some cases, the documentation was not received at all which resulted in a limitation of scope being placed on the audit.
62. The municipality has a financial management system in place. Despite this, numerous instances were identified where the municipality did not have manual or automated controls designed to ensure that the transactions had occurred, were authorised, and were processed completely and accurately.

Governance

63. Risk identification and management processes are not designed to identify changes in processes or risks and to verify that the design of underlying controls remain effective. The municipality has not selected and developed internal controls to prevent, detect and correct material misstatements in financial reporting and reporting on predetermined objectives.
64. The municipality did not have an audit committee and an internal audit function that promoted accountability and service delivery through evaluating and monitoring responses to risks and providing oversight over the effectiveness of the internal control environment, including financial and performance reporting and compliance with laws and regulations. These bodies did not carry out their responsibilities in a manner consistent with the requirements of the MFMA. In addition municipality did not have an audit committee throughout the year (as they resigned).
65. The internal audit unit did not assist management in maintaining effective and efficient controls over the information system environment, the reliability and integrity of financial and performance information, and compliance with laws and regulations.

Auditor General.

East London

30 November 2011



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence